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Via Electronic Filing
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
445 12th St., S.W.
Washington, DC 20554

Re: Application by Verizon New England Inc. et al. to Provide In-Region InterLATA Services in Rhode Island CC Docket No. 01-324

Dear Mr. Caton:

AT&T submits this *ex parte* letter to reply to Verizon's *ex parte* dated February 8, 2002 ("Verizon Feb. 8 *Ex Parte*"). In this letter, Verizon attempts to respond to AT&T's showing, in its *ex parte* letter dated February 1, 2002, that the recent order of the New York Public Service Commission ("NYPSC") has eliminated the only ground on which Verizon had sought to defend its rates for unbundled switching: that they are lower than or comparable to those that were adopted in New York based on data from 1997 and imported into Massachusetts in 2000. However, Verizon does not dispute that the comparability to the old New York rates was the sole basis on which it had argued that its Rhode Island switching rates could be found to satisfy TELRIC and that it refused to defend the methodology and inputs used to derive these switching rates. Nor does Verizon dispute that the *Massachusetts 271 Order* held that Verizon would lose the ability to rely on this old New York "benchmark" once the NYPSC adopts lower rates. Nonetheless, Verizon now urges the Commission to grant the application by misstating AT&T's claims and by raising a series of eleventh hour claims that are barred as a matter of procedure and insufficient as a matter of law and fact.

Foremost, it is elementary that in a section 271 proceeding, the BOC applicant bears the burden of demonstrating that its prices for UNEs are cost-based and otherwise meet the requirements of section 271. Typically, the BOC must demonstrate that its rates comply with the Commission's TELRIC methodology. In the absence of such a showing, the Commission has also found that under some circumstances the BOC may demonstrate that its UNE prices are comparable to "benchmark" rates that the Commission has previously found to comply with TELRIC. In approving Verizon's section 271 application for Massachusetts, for example, the Commission relied on the fact that Verizon's rates for that state were comparable to temporary rates that were adopted (subject to refund) by the New York Public Service Commission ("NYPSC") in 1997, and that were applicable when the Commission approved Verizon's Section 271 application for New York in 1999. This approach necessarily requires, however, that the rates chosen as the benchmark themselves be consistent with TELRIC. Consequently, the Commission's *Massachusetts 271 Order* also stated that "[i]f the [NYPSC] adopts modified UNE rates, future section 271 applicants could no longer demonstrate TELRIC compliance by showing that their rates in

the applicant states are equivalent to or based on the current [1997] New York rates, which will have been superceded." *Massachusetts 271 Order,* ¶ 29; *accord* 16 FCCR at 9143 (Statement of Chairman Powell).

As AT&T showed in its Opening Comments, its Reply Comments, and in a February 1, 2002 letter ("AT&T Feb. 1 *Ex Parte*"), Verizon has neither demonstrated that the state commission properly found that Verizon's UNE switching rates comply with TELRIC nor relied on a proper benchmark for its unbundled switching rates. In particular, AT&T showed that there were numerous clear errors in the application of TELRIC methodology to Verizon's current Rhode Island switching rates, and that those errors precluded any finding that those rates are cost-based. These errors included, in particular, the fact that the usage sensitive unbundled switching rates in Rhode Island had been simply imported from *proposed* switching rates in Massachusetts, even though the inputs Verizon used to calculate its proposed Massachusetts rates were patently inconsistent with TELRIC principles that the Rhode Island PUC adopted.[1] Verizon's *only* response to AT&T's showing in its Reply Comments was that "there is no need" for the Commission to examine the errors shown by AT&T, because Verizon's rates complied with the Commission's benchmark approach: "the final rates [in Rhode Island] are lower (relative to cost levels) than the rates that the Commission approved in Massachusetts and New York." Verizon Reply Comments at 15.

In AT&T's Feb. 1 *Ex Parte*, AT&T demonstrated that Verizon's application must be denied in light of the January 28, 2002 Order of the New York Public Service Commission (NYPSC),[2] which set new UNE rates in New York that were significantly lower than prior rates in New York and Verizon's current rates in Rhode Island. Because the NYPSC has now "superceded" the 1997 rates upon which Verizon relies as a benchmark, the only evidentiary support that Verizon relied upon for its claim that its Rhode Island switching rates are cost-based has been eliminated. Pursuant to the *Massachusetts 271 Order*, therefore, Verizon's application must be denied.

Confronted with the collapse of its sole defense of its UNE switching rates, Verizon makes a number of claims in its Feb. 8 *Ex Parte*. Each of them is spurious and either ignores or patently misstates AT&T's contentions.

First, Verizon's principal claim is that AT&T is arguing that Verizon's Rhode Island switching rates must "be set at the lowest level adopted in any state," or that Verizon must "adopt th[e] same rates [as those in New York] in Rhode Island." Verizon Feb. 8 *Ex Parte* at 1, 4, 11. But that flatly misrepresents AT&T's argument. AT&T's claim is simply that Verizon must show that its UNE rates comply with TELRIC.[3] It was Verizon – not AT&T – that attempted to make that showing exclusively by relying on the New York PSC's old rates (based on 1997 data) as a benchmark.[4] Now that the switching rates Verizon chose as its benchmark have been superseded, Verizon's application must be denied.

Second, Verizon repeatedly claims that it may continue to rely on the old NYPSC UNE rates, even though those rates have been superseded by the recent *NYPSC Order*. That argument, however, squarely contradicts the Commission's holding in paragraph 29 of its *Massachusetts 271 Order*, in which the Commission clearly explained that Verizon would not be able to rely on the old New York UNE rates in future applications, like this one, once

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[1] *See* In re: Review of Bell Atlantic-Rhode Island TELRIC Study, Docket No. 2681, Report and Order No. 16793, at 20-21, 35 (R.I. Pub. Util. Comm'n Nov. 18, 2001) ("*RI PUC Nov. 18 Order*"), VZ-RI App. F., Tab 34 (a link to this Order may also be found at www.ripuc.org/order/tele.html).

[2] Order on Unbundled Network Element Rates, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Case 98-1357 (January 28, 2002) ("*NYPSC Order*").

[3] Verizon also makes the related procedural argument that reliance on the rates in the *NYPSC Order* is improper because Verizon need not "demonstrate that it complies with rules that become effective during the pendency of its application." Feb. 8 *Ex Parte* at 10. But rejection of Verizon's Rhode Island switch prices does not require Verizon to come into compliance with a new rule. The rule is – and always has been – that Verizon's rates must comply with TELRIC. This is simply a case where, in attempting to show compliance with this existing rule, Verizon chose to rely exclusively on evidence that is now superceded. Rejection of such evidence in no way requires compliance with a new rule, nor, given the long pendency of the New York decision, does it unfairly surprise Verizon.

[4] For this reason, there is no merit to Verizon's claim that AT&T "implies that the Commission's benchmark test is an independent statutory requirement." Feb. 8 *Ex Parte* at 13. Again, it was Verizon that elected to ignore AT&T's demonstration of the TELRIC errors that infected Verizon's Rhode Island switching rates and instead to defend those rates by relying on the benchmark test. The statutory requirement is for cost-based rates; the benchmark approach is the way that Verizon chose to attempt to meet that statutory test.

those rates have been superseded. *See* AT&T Feb. 1 *Ex Parte* at 9. That has now occurred, and any reliance on the former NYPSC rates would plainly be unlawful and arbitrary.

Verizon suggests that reliance on those rates is nonetheless proper because the NYPSC did not expressly state that its former rates violated TELRIC, but has instead simply adopted more current rates based upon more current information. Verizon Feb 8 Ex Parte at 3, 5-6. Preliminarily, it is plain that the NYPSC's new rates do in fact reflect an effort to correct the improper inflation of the old rates attributable to Verizon's false statements regarding switch discounts. *See* AT&T Feb. 1 *Ex Parte*. The recently-filed New York settlement agreement provides for refunds as a result. But more fundamentally, the point is irrelevant. Paragraph 29 of the *Massachusetts 271 Order* – which Verizon never even cites – made this explicit:

> "We note, however, that the New York Commission is actively investigating UNE rates and may modify those rates *to reflect changed market conditions, technologies, and information. If the New York Commission adopts modified UNE rates*, future Section 271 applicants could no longer demonstrate TELRIC compliance by showing that their rates in the applicant states are equivalent to or based on the current New York rates, which will have been superceded."

Massachusetts 271 Order ¶ 29 (emphasis added). Thus, even if the only basis for the changes in the New York rates were "changed market conditions, technologies, and information," Verizon's attempt to "demonstrate TELRIC compliance by showing that [its] rates" are equivalent to the old New York rates must be rejected.

Third, Verizon asserts that, rather than deny the application or require Verizon to adopt the 2002 New York rates, the proper solution is to approve the application – by designating the current Rhode Island rates as "interim" – and to await action by the Rhode Island PUC, which has indicated it may set new UNE switching rates in a future proceeding. *See* Verizon Feb. 8 *Ex Parte* at 7-9. That action would be unlawful, because Verizon has failed to provide any evidence that its current unbundled switching rates are reasonable and consistent with TELRIC. The Commission has permitted reliance on interim rates, but only where there is some evidence that the interim rates themselves comply with TELRIC and the state commission will act promptly to implement final rates. Not only has Verizon failed to explain why rates that purport to be final may be excused from the checklist by re-labeling them as "interim," but Verizon also has not demonstrated that the Rhode Island PUC will quickly adopt replacement rates. The Rhode Island PUC has not even opened a docket to investigate new UNE rates, let alone provided a firm schedule by such rates would be in place.

Verizon makes a number of additional assertions, none of which could fill the evidentiary gap in its application even if true.

- Verizon proclaims (at 2-3) that its "Phase I" Rhode Island rates were based on "key" input assumptions "including a 9.5 percent cost of capital" that "are entirely consistent with what this Commission has found TELRIC compliant in the past." But Verizon's Rhode Island application is not based upon its Phase I switching rates, which Verizon superseded with UNE switching rates that it claims are equivalent to those it has proposed in Massachusetts. And *those* rates rely upon input assumptions, such as a *12.6 percent* cost of capital that are even more extreme than assumptions that the Commission has previously criticized and that are plainly not TELRIC compliant. *See Massachusetts 271 Order* ¶ 38.

- Verizon disingenuously claims that "it is not yet even clear what the new rates in New York will be." Feb. 8 *Ex Parte* at 3. On February 8, 2002 – the same day Verizon filed its *ex parte* with the Commission – Verizon also made a filing with the NYPSC that both agreed to the rates ordered by the NYPSC and provided for a refund mechanism for carriers that paid the old inflated rates. Verizon is likewise wrong in asserting that the NYPSC's decision "will not take effect" until February 28th. The *rates* that Verizon files may not take effect immediately, but the first page of the NYPSC Order states that the *order* is "Issued and Effective January 28, 2002."[5]

[5] Moreover, as the Rhode Island PUC's own orders make clear, the "key" input assumptions in the superseded Phase I rates also departed from TELRIC principles far more often than they complied with them. *See RI PUC Nov. 18 Order* at 16-67 (noting 14 key TELRIC input assumptions, of which only 3 were embodied in the Phase I rates). Verizon likewise misleads when it contends that the Phase I rates did not face "any meaningful opposition." AT&T explained in writing that it was not challenging the interim Phase 1 rates only on the understanding that the PUC's

- Verizon contends that the Commission can simply defer to the Rhode Island PUC's finding, "based upon the record evidence," that the rates upon which the application is based – which Verizon concedes were hotly contested, *Ex Parte* at 2-3 – are TELRIC compliant. In fact, however, as AT&T explained in its comments and reply comments, *see* AT&T Comments at 1-4; AT&T Reply Comments at 1-3, the PUC held no hearings and provided no analysis and, instead, merely noted that the new switch rates compared favorably to the then-existing switching rates in New York and Massachusetts – the very benchmark shortcut that the Commission's prior rulings forbid.

- Verizon's claim that "the rates that are now in effect in Rhode Island are significantly *lower*" than the old New York rates, and that Rhode Island is therefore "hardly an outlier," Feb. 8 *Ex Parte* at 5, can only be designed to mislead. Verizon compares only the *usage* elements of the switching rates and ignores that the Rhode Island switch port charge is nearly twice as high as even the old New York port charge. When switching rates as a whole are considered, the Rhode Island rates are *higher* than the old New York rates (and about *double* the new New York rates). Verizon provides the same incomplete comparison to New Jersey; the Rhode Island rates are, in fact, more than 70 percent higher than the New Jersey rates, when all switching charges are considered.

- Verizon attempts for the first time, in a single footnote, to respond to AT&T's showing that Verizon's existing Rhode Island switching rates reflect clear errors in the application of TELRIC. *See Ex Parte* at 8-9 n.28. AT&T's declaration demonstrated four such errors. Verizon addresses only two, and its responses are patently inadequate. With respect to the new switch/growth discount issue, for example, Verizon points out that "the Commission and the D.C. Circuit have acknowledged that a mix of new and growth switches is appropriate" (*id.*) – an assertion that overstates the Commission's and Court's holdings vis-à-vis the New York Section 271 application. But contrary to Verizon's claim, its existing Rhode Island rates do not reflect any such mix; rather, they are based upon an assumption of *100 percent* growth additions and *no* new switch discounts. In fact, as the Rhode Island PUC has recognized, the "appropriate mix," consistent with TELRIC principles in Rhode Island, requires the use of only 10 percent growth additions and 90 percent new switch discounts. *See RI PUC Nov. 18 Order* at 35; AT&T Comments at 8-9. Likewise, Verizon's claim that the cost of capital used to derive Verizon's Rhode Island switching rates is appropriate is highly misleading. In fact, Verizon fails to acknowledge that, because its switching rate was imported from Massachusetts, the rate is based on a 12.6 percent cost of capital that this Commission itself criticized (*Massachusetts 271 Order* ¶ 38) and that the Rhode Island PUC determined was inappropriate for use in Rhode Island. *See RI PUC Nov. 18 Order* at 20-21. That cannot possibly be consistent with TELRIC principles.[6]

Cost-based UNE rates are and remain one of the most critical inputs that will determine whether competitors are able to compete with the incumbent LEC in the local marketplace. Allowing Verizon or any other carrier in a section 271 proceeding to continue to rely, as a "benchmark," on UNE rates that were set based on five year old data from another state would dramatically curtail the pricing oversight required by section 271 itself. In a declining cost industry such as telecommunications, the effect of doing so would simply be to insulate section 271 applicants from significant local competition. Any attempt to ignore those substantial cost declines would not only injure competition, it would also be arbitrary, capricious, inconsistent with the Commission's TELRIC methodology, and inconsistent with the Act's principal objective. Because Verizon has failed to demonstrate that its prices for unbundled network elements comply with the Commission's TELRIC methodology, and has not identified comparable benchmark rates that remain valid, its application must be denied.

One copy of this Notice is being submitted for each of the referenced proceedings in accordance with the Commission's rules.

Very truly yours,

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approval of those rates as *interim* rates would not delay completion of cost proceeding to establish TELRIC-based rates.

[6] Verizon's cost of capital is excessive largely because Verizon improperly assumed a single growth rate and, in particular, that Verizon would grow faster in perpetuity than the economy as a whole. That is impossible, and is necessarily inconsistent with TELRIC.

Robert W. Quinn, Jr.

cc: Michael Powell, Chairman
Kyle Dixon
Kathleen Abernathy, Commissioner
Matthew Brill
Michael Copps, Commissioner
Jordan Goldstein
Kevin Martin, Commissioner
Sam Feder
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John Rogovin
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